Highland City

DRAFT

Highland Development Center

Market Analysis and Fiscal Impacts Study

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ZIONS PUBLIC FINANCE, INC.

Background and Overview

The purpose of this study is to evaluate the fiscal impacts on Highland City of the Development Center property if the property is developed under various scenarios as described in this report. There are two main components to the report:

- Market study conducted by ZPFI; and
- Fiscal analysis of various development scenarios
  - Development Center development assumptions
  - ZPFI market study
  - Sensitivity analysis to various types of development

FIGURE 1: SITE MAP

These two development scenarios, along with sensitivity analysis are presented below.

- *Scenario 1* - The assumptions used in the Utah State Developmental Center Properties Master Plan, dated June 2013, and prepared by DesignWorkshop;

TABLE 1: SCENARIO 1 – DEVELOPMENT ASSUMPTIONS

Development Type	**Total SF**	**10-15 Yrs**	**15-25 Yrs**
Grocery Retail	35,000	35,000	0
Restaurants	30,000	20,000	10,000
In-Line Retail	30,000	20,000	10,000
Pad Retail	25,000	15,000	10,000
Office	30,000	20,000	10,000
Single-Family Development	180	100	80
Townhomes	120	80	40
Apartments	400	200	200
Senior Housing (Apartments)	150	100	50
Senior Housing (Detached)	75	50	25

Source: Utah State Developmental Center Properties Master Plan, prepared by DesignWorkshop, June 2013

- *Scenario 2* - Market study conducted by ZPFI in February and March of 2017

TABLE 2: SCENARIO 2 – DEVELOPMENT ASSUMPTIONS

Use Type	**Total SF Supportable**	**10-15 Yrs**	**15-25 Yrs**
Grocery	35,000	35,000	
Restaurants/Pad Retail	25,000	15,000	10,000
In-Line Retail	15,000	7,500	7,500
Office	30,000	15,000	15,000
Single-Family Homes	200	100	100
Townhomes/Attached	125	75	50
Apartments	250	150	100
Senior Housing - Apartments	100	75	25
Senior Housing - Detached	125	50	75

- Sensitivity analysis for fiscal impacts associated with the property due to higher or lower development of various property types and varying property values.

The deliverables for this study include:

- Excel spreadsheet that allows for sensitivity analysis of the fiscal impacts of different absorption estimates and varying types of development
- Written report that summarizes the research from the market analysis and the assumptions used in the fiscal impacts analysis

Key Findings

Market Analysis

The market analysis shows demand for residential and commercial development in Highland, albeit at slightly reduced levels than those proposed by the Utah State Developmental Center Properties Master Plan. The following are noted as key findings regarding the market analysis:

- The residential market for Highland is considered strong, with brokers and developers indicating solid demand from potential buyers for both attached and detached housing
- The senior housing market is presently healthy, with strong demand for developments in desirable communities that have a more "aged" population (i.e., limited students, more established families, etc.)
- Caution was suggested for significant apartment construction in Highland, as market demand for this use type is stronger in neighboring communities, while returns on single-family and townhome product are higher in Highland
- Retail growth will be somewhat limited, although a grocery store should be supported, as well as possible restaurant clusters. In-line retail will likely be nominal
- Office construction appears supportable, although with a gradual absorption period. Returns on office construction (considering total costs of development and land) appear attractive, while pre-leasing or build-to-suit options would greatly reduce risk

Fiscal Impacts

Scenario 1 – Development Center Market Demand Assumptions

- Fiscal impacts are positive over 20 years by over $1.2 million
- However, the first four years of development are roughly breakeven
- The last few years of the project timeframe studied (20 years) show net negative revenues. This is because inflation is projected to increase more quickly than an increase in revenues
- Sensitivity testing of Scenario 1 shows the following:
  - If grocery retail is not included, net revenues over 20 years are estimated at $127,000.
  - If grocery retail is included, but all other commercial is deleted, the net revenues are negative at ($712,905).
  - If residential and commercial are at full market value[1] (as identified in the ZPFI study), then net revenues over 20 years increase to nearly $1.6 million.

[1] Market values have been discounted by ten percent to account for the fact that Utah County Assessor's valuations are often beneath market values.

Scenario 2 – ZPFI Market Demand Assumptions
The ZPFI market analysis provides for somewhat lower net revenues, largely due to the reduced amount of commercial space.

- Net revenues over 20 years are expected to reach $694,451
- If the residential projections hold, but there is no commercial development, other than the grocery store, net revenues are negative at ($317,168)

Summary
The fiscal impacts analysis shows that in order to achieve positive fiscal impacts from this development, there must be commercial development over and above that of the grocery store. How much commercial development, in addition to the grocery store, must take place?

- 15,000 sf of in-line retail over 25 years; or
- 10,000 sf of restaurant/pad retail by year 10; or
- 30,000 sf of office over 25 years plus 4,000 sf of retail by year 4
- Other combinations are possible; the above are examples of the general magnitude of commercial development that is required, along with timeframe.

Market Analysis

Residential Analysis

Consideration is first given for residential market conditions. Presently, housing prices in Highland are notably higher than numerous other communities in Utah County. Prices have risen in the last several years, although the increase in values has not been substantial enough to warrant concern of over-inflation. Presently (as of February 2017), single-family homes show a median value in Highland of $485,000. Based on a median home size of 3,100 square feet, this sums to $156 per square foot of livable area. Current, active listings show a higher median value of $540,000, which may show some flexibility between ultimate sales prices and asking amounts.

A survey of recent sales and active listings in the local area market, with a focus on homes near the subject property, revealed an average price of $417,000. The average home price was indicated at $137 per square foot, with an average size of 3,272 square feet. Without the high and low-end indicators, the average drops to closer to $375,000. The subject's units will have an inferior location to some of the surveyed product, and based on the likely density of development, may ultimately show slightly lower overall values. Consequently, this analysis assumes a single-family home price of $350,000. While notably below the citywide figure, this is appropriate due to the location and assumed density of development.

Absorption of single-family homes will likely be healthy, considering current and forecast market conditions. Based on representations made by brokers and developers, as well as consideration for other developments in Utah County, single-family homes will be well demanded. Some hesitation is made regarding the likely lot sizes for the properties, as this is a significant consideration for most buyers in Highland. Nonetheless, it is feasible to consider upwards of 200 single-family homes for the site.

Townhomes were also surveyed for this study, and show a citywide average of roughly $275,000. Data was also taken from recent sales and active listings of townhomes in relative proximity to the subject, with a noted, average value of $255,000, or, roughly $132 per square foot. Townhome construction has become more attractive in recent years due to its perceived affordability over detached housing. Brokers anticipate continued, solid demand for this use type. The forecasts made by the Utah State Developmental Center Properties Master Plan for townhomes appear supportable. An average price of near $250,000 is likely attainable for the subject property. Absorption will most likely be healthy, with approximately 75 units absorbable within the first study period (1-15 years).

Consideration is also made for apartments. This use type has experienced record growth and demand throughout Utah County in the past seven years. This is due to strong population growth, a healthy labor force, and available financing at low rates. Increases in lending rates for single-family home buyers may force some potential occupants into apartments, although Highland does not appear to be a market that will experience significant changes due to gradually increasing rates. Some concern is noted by market participants in the overall market regarding a saturation of apartment rentals. Brokers further cautioned that Highland has greater strength and appeal for detached-product buyers than for apartments. Returns on investment for single-family homes in the area are strong, and likely outweigh the potential risk of an apartment market that has greater appeal in neighboring cities with different demographics.

Comparables show support for apartment values at $150,000 per unit. The site could likely support three-story construction, with parking in surface lots, or, in interior courtyards. Presently, parking garages do not appear to be financially feasible. Total absorption is herein forecast at 250 units, based on developers, brokers, and the history of neighboring communities. This is moderately below the predictions of the master plan, but recognizes that more space should be attributed to single-family homes and detached, senior housing.

Senior housing is presently experiencing solid demand in numerous communities in Utah and Salt Lake Counties. A growing population of the 55+ age group is fueling demand for senior-oriented developments. While many of these do not provide any hospice or attentive care facilities or amenities, they do offer shared common areas and have community events. Brokers indicated that Highland has great appeal to seniors due to its relative quiet atmosphere, proximity to basic services, and siting within Northern Utah County. Furthermore, Highland enjoys a relative cachet amongst homeowners for being a place with strong financial valuations.

Comparable senior housing is somewhat limited, although provides support for detached housing at an average market value of $275,000. Senior apartment demand, similar to standard apartments, may have some limited appeal, but will nonetheless be filled by a growing populace. An average, per unit price of $150,000 is supportable. Absorption of senior housing should be healthy, with brokers indicating that a well-built project with proper amenities could support upwards of 125 detached units. Active seniors still prefer the detached units, particularly in Utah, in order to provide some yard space for visiting guests.

Office Analysis

The office market throughout Northern Utah County is healthy at present, with significant absorption having occurred in 2015 and 2016. Plans for future development are substantial, with some indicating concerns about potential over-building. Nonetheless, the robust employment market and continued population growth, coupled with the expansion of educational centers, have fueled a need for more office space. Most of this growth, however, is occurring along well-traveled corridors that provide visibility and exposure characteristics that are not achievable at the subject site. Overall, however, there still exists some moderate demand for more suburban, in-fill type office development, albeit at conservative sizes.

Office valuation is based on currently achievable rental rates for property deemed similar to what could be built at the subject. Numerous comparable data points were pulled to reflect the present market, and overall show an achievable rental rate of $18.00 per square foot, triple net. This lease structure requires the tenant to pay for nearly all operating expenses, and is reflective of a good quality building in similar condition. Total expenses for operation, when deducted from potential gross income, show net operating income that is then capitalized by a rate reflective of the investment appeal of the development. Overall, considering developer and broker inputs, comparable data points from sold and listed office properties, as well as a valuation analysis of achievable income and expenses, an office property could have an estimated value near $225 per square foot.

Absorption of 30,000 square feet appears supportable for office space at the subject property. This could be achieved through multiple buildings, or, with one, multi-story structure with surrounding surface parking. Demand is moderately healthy, although the secondary location will likely result in some need for pre-leasing, or a build-to-suit tenant to spur additional construction.

Retail Analysis

Retail market conditions are tenuous at present, considering the vacancy rates in some suburban, secondary markets. Brokers suggest some concern about retail trends, due to historical underperformance from big-box stores and customer trends for online shopping. Nonetheless, the subject's desirable median incomes in near proximity will have appeal to retailers. Additionally, if the proposed residential uses are added, the area will gain in retail desirability.

Visibility and exposure, due to only moderate traffic counts, are a consideration for future retail use. The area has need for an additional grocery store, with the proposed residences also adding to this need. At 35,000 square feet, a grocery store could be added in the initial years of project absorption. Grocery rents and expenses show valuation potential between $115 and $125 per square foot, with support from comparable sales throughout the region. Pad parcels will have moderate appeal, and could have demand as restaurant clusters. Uses should be focused on the more upscale nature of Highland, and with consideration for the potential of nearby office support (albeit limited). Pad retail parcels typically reflect the highest values of all retail product, due to their increased visibility and exposure, and relatively small sizes in relation to in-line or anchor spaces (smaller spaces have higher values on a per square foot basis, all else equal). Support for restaurants and pad parcels is shown at $225 per square foot. This is highlighted by achievable comparable rents and expenses from nearby developments, with forecast income capitalized by an acceptable rate of return. Additional data is shown in the Appendix of this report regarding retail valuation. Restaurants will likely range in size from 2,000 to upwards of 5,000 square feet. If three or four pad sites are improved with restaurants, then 10,000 to 15,000 square feet could be feasible in the initial absorption period. Additional pad sites would have potential demand from credit unions and banks, resulting in some quasi-office/retail uses. Overall, a total of 25,000 square feet could be absorbed at the subject property from pad parcels.

Finally, in-line suites are discussed. This property type is currently suffering within the retail category, as it depends upon anchors and junior anchors to drive traffic. As many big box stores have experienced hardships, in-line suites have become vulnerable. Nonetheless, the presence of a grocery anchor will provide need for some supporting stores such as salons, coffee shops, small eateries, etc. These suites will likely be less than 2,000 square feet, and will need to be positioned to best capture visibility and exposure from the roadway, as well as from the grocery anchor. Brokers and developers anticipate that the site could ultimately support between 10,000 and 20,000 square feet of in-line uses, assuming a grocery anchor and restaurant pads are also in the development plan. Values for these use types are shown by comparable properties throughout the region, reflecting a supportable rate for the subject property at near $175 per square foot.

Fiscal Impacts Analysis

Revenues

Property Tax

- All residential development was assumed to be primary residential units and therefore taxed at 55 percent of market value
- Highland City's property tax rate = 0.001494
- Market values were assumed as follows and were then reduced by ten percent to account for the lower valuations generally made by the Utah County Assessor's Office.

TABLE 3: PROPERTY VALUATION ASSUMPTIONS

Development Type	Market Value	Reduced Valuation
Single-Family Unit Market Value	$350,000	$315,000
Townhome Unit Market Value	$250,000	$225,000
Apartments Unit Market Value	$150,000	$135,000
Senior Housing (Apts) Market Value	$150,000	$135,000
Senior Housing (Detached) Market Value	$275,000	$247,500
Grocery Retail Value per sf	$120	$108
Restaurants per sf	$225	$203
In-Line Retail per sf	$175	$158
Pad Retail per sf	$225	$203
Office per sf	$225	$203

Sales Tax

Sales tax revenues are distributed both on population and point of sale (1/2 of one percent local option tax).

- Per capita distribution = $85
- 2016 population = 16,619 residents
- Point of sale revenues per sf = $250

- Average household size:

TABLE 4: HOUSEHOLD SIZE ASSUMPTIONS

Residential Development Type	HH Size
Household Size - Single Family	4.4
Household Size - Townhome	3.5
Household Size - Apts	3.0
Household Size - Sr. Housing (Apts)	1.5
Household Size - Sr. Housing (Detached)	1.7

Class C Road Funds
Class C road funds are distributed both on population and weighted[2] road miles.

- Per capita population distribution = $26.71 (based on UDOT 2016 distribution)
- Per weighted road mile = $651.12 (based on UDOT 2016 distribution)
- Existing weighted road miles in Highland = 445.75
- Population (16,619) + employment (2,662) = 19,281 (population and employment)
- Weighted road miles per capita/employee = 0.023118614[3] (used to project the future road miles associated with the development)

Expenses

Most expense categories are evaluated on two criteria (shown in Columns B and C on the Excel worksheet): “Basis” and “Percent Variable.”

Basis refers to the “driver” of the expense category. In other words, is it formula driven (at least in part) such as the Lone Peak Safety Fund, or is it driven by population growth, employment growth, or a combination of both population and employment? Using the City’s FY2015-2016 General Fund Budget, the cost per capita and per employee has been calculated. The spreadsheet then applies these cost drivers to each expense category in the General Fund.

The “% Variable” category refers to the difference between fixed and variable costs. This column indicates the extent to which this expense category increases due to increased population or employment (i.e., residential or commercial) growth in the City.

Inflationary factors have also been considered and are included in Column A of the Excel spreadsheet.

Lone Peak Safety Fund
The Lone Peak Safety Fund is divided into three parts:

[2] Weighted road miles are calculated based on the following: 5x for paved roads; 2x for gravel roads; and 1x for dirt roads.
[3] Calculated by dividing the total weighted road miles (445.75) by the total number of residents and employees in the City (19,281)

1. Fire, Ambulance and EMS
   - 10% base fee to cities
   - 45% population (16,619) = $28.68 per capita
   - 45% ERUs (4,491) = $106.15 per ERU

2. Administrative
   - Population (16,619) = $8.47 per capita

3. Police
   - Population (16,619) = $111.97 per capita

How the Excel Model Works

The Excel model was designed to allow the City to use the financial model for further sensitivity testing of the Development Center site, as well as evaluation of other development scenarios in the City. The model evaluates the fiscal impacts to the City's General Fund – both revenues and expenses. However, not all revenue and expense categories were included in our analysis. Those categories not included are the following:

- Fees for planning and development services were not included, nor were the accompanying expenses, assuming that the fees charged should offset the expenses incurred
- Cemetery revenue and expenses
- Some miscellaneous categories not impacted by development, such as PSD rent, Alpine reimbursement, etc.
- Garbage and sanitation

Assumptions Tab
All cells *highlighted in blue* can be changed to account for different factors such as the following:

- Different property valuations by property type
- Highland City property tax rate
- Varying distributions, from year to year, for sales taxes (per capita distribution) and road funds
- Demographic characteristics such as population, household size and employment

Absorption Tab
All cells *highlighted in blue* can be changed to account for different factors such as the following:

- Different numbers of units absorbed by year, by type

Budget Tab
Columns A, B and C, *where shaded in blue*, can be adjusted for sensitivity analysis.

Column A
Column A allows testing of inflationary factors.

Column B
Column B determines the formula used to calculate the revenues or expenses. Only a 1, 2 or 3 can be input into Column B.

1 = population drives the revenue or expense
2 = employment drives the revenue or expense
3 = both population and employment drive the revenue or expense

In some cases, not shaded in blue, the revenue or expense is formula driven and is indicated in column B for that particular line item.

Column C
Column C deals accounts for the difference between fixed and variable costs. For example, salaries and wages for the City Council do not vary with any type of new development. They are fixed in nature. Therefore, the % variable that needs to be input into Column C, would be 0 percent in this case. On the other hand, court salaries and wages are directly related to the population and employment in the community. As population and employment grow, so will court costs (and court revenues from fines, as well). In this case, 100% has been put in column C.

Summary Tab
This tab presents a year-by-year comparison of total revenues and expenses. There are no inputs on this tab.

Historic Budgets
This tab includes Highland's FY2015-2016 budget and is the basis for calculating per capita and per employee expenses as shown on the Budget tab. There are no inputs on this tab.

Appendix A – Direct Capitalization Office

	Building Area	Estimated Market Rent (Per Sq.Ft.)	Annual
Office Space	10,000	$18.00	$180,000.00
Total Leasable Area	10,000	$18.00	
Common Area Maintenance Reimbursements			$11,000.00
POTENTIAL GROSS INCOME (PGI)			$191,000.00
Vacancy Loss (5.0% of PGI)			($9,550.00)
EFFECTIVE GROSS INCOME (EGI)			$181,450.00
Operating Expenses			
Common Area Maintenance			($11,000.00)
Management			($5,443.50)
Reserves			($1,814.50)
Total Operating Expenses			($18,258.00)
NET OPERATING INCOME (NOI)			$163,192.00
Capitalization Rate			$0.07
Estimated Market Value			**$2,250,924.14**
		Per Square Foot Stabilized:	**$225.09**

Appendix B – Direct Capitalization - Retail

	Building Area	Estimated Market Rent (Per Sq.Ft.)	Annual
Retail Space - Multi-Suite	10,000	$21.00	$210,000.00
Total Leasable Area	10,000	$21.00	
Common Area Maintenance Reimbursements			$11,000.00
POTENTIAL GROSS INCOME (PGI)			$221,000.00
Vacancy Loss (5.0% of PGI)			($11,050.00)
EFFECTIVE GROSS INCOME (EGI)			$209,950.00
Operating Expenses			
Common Area Maintenance			($11,000.00)
Management			($6,298.50)
Reserves			($2,099.50)
Total Operating Expenses			($19,398.00)
NET OPERATING INCOME (NOI)			$190,552.00
Capitalization Rate			$0.08
Estimated Market Value			**$2,309,721.21**
		Per Square Foot - Stabilized:	**$230.97**